Bonds: The Forgotten Asset Class

Solutions Outside the Box vs. Out-of-the-Box

Over the 15 years ending 12/31/2024 the US Aggregate Bond index averaged just over 2.3% per annum. In contrast the S&P 500 posted a return of over 14.3% per annum. It's no wonder many investors have forgone or forgotten meaningful allocations to bonds.While bonds barely kept pace with inflation for 15 years, equities provided a huge wealth compounding impact.

We believe an allocation to bonds today may prove as meaningful as at any point in the last 4 decades.

With forward-looking expectations by Wall Street "expects" considerably lower than the returns generated in the last 15 years, coupled with high nominal yields, bonds have a real ability to play a meaningful role in a client's portfolio.

While investors often refer to "the bond market" as if it's a single homogenous market, there are more than 100,000 different bond Cusips in circulation today. As a point of reference, there are ~6,000 publicly traded US stocks traded on the NYSE and Nasdaq exchanges. The value of the global bond market is nearly twice as large as the US Equity markets.

daniel.head@hip3.net
865.999.5332

What's the point?

There are many types of bonds and the range spans widely, from risky to very safe. A skilled manager can comb through thousands of bonds to identify those that fit his eye.

As you can see, the list is extensive and includes a wide array of credit types. Accordingly, the potential risk/reward also can vary widely. Not only can a bond's return vary based on its issuer, it will also move differently in the open markets based on its maturity, call features, and collateral/balance sheet backing it. Some bonds move more based upon credit fundamentals (High Yield, CMBS, ABS) while others move almost exclusively based on interest rate dynamics (Gov't bonds, Agency Bonds).

Below is a partial list of the types of taxable bonds you may see in a portfolio manager's holdings:

- US Government Bonds
- US Agency Bonds
- Investment Grade Corporates
- High Yield Corporate Bonds
- Taxable Municipal Bonds
- Consumer ABS
- Non-Agency RMBS
- Senior Secured Bank Loans
- Collateralized Loan Obligations (CLO)
- Commercial Mortgages (CMBS)
- Non-US Government Bonds
- Non-US Corporate Bonds

Customized Bond Allocation

What's Differentiated about Our Approach?

Our team takes an active approach to bonds. Not only do we actively oversee and manage the managers we employ, but also the portfolio's rate exposure and sector allocations. We believe there are seasons when taking on more duration serves an investor well (like 2008) while shorter duration offers greater flexibility and less rate sensitivity. When risk reward skews favorable, we look to profit. When risk-off is the appropriate positioning, we look to become more defensive.

The bond market is riddled with inefficiencies our managers can take advantage of. Whereas trading a stock today is as simple as pushing a button, buying or selling a bond is more akin to selling a car. You find a bidder (or a few) and go back and forth until you accept an offer. Some markets are heavily owned by pension funds and insurance companies, others are much smaller and have more nuanced ownership.

Along with an active approach, our team views bonds in the context of the client as well. For some clients, bonds are a source of needed income. For others, they serve as a volatility dampener and source of total return. Each client's bond allocation is customized to that client's needs and based upon market conditions at the time funds are deployed. When we make tactical shifts at a position level, clients who own that position will be impacted while others may not be.

The Bottom Line on Bonds...

Not all bonds are the same. Not all clients' needs are the same. *The role in client portfolios is often not the same!* You deserve a customized solution. Benchmarking your bond portfolio to the Bloomberg Bond Aggregate Index could again disappoint in the next decade. **<u>Our aggregate client bond allocations outpaced the bond index by nearly 10% across the 2 years ended 12/31/2024!</u>**

We will customize and oversee a bond mix designed for your specific goals and objectives. We feel reasonably certain the bond markets will offer both challenges and opportunities for the disciplined and skilled investors in the next decade.

Bonds can seem complicated and yet offer one of the most straightforward risk/reward profiles to investors. Rather than signing up to become a bond expert, enlist our team who can help identify managers and strategies that can take advantage of the bond markets' many inefficiencies. The impact on your portfolio's risk and returns could be impactful!

HEAD
INVESTMENT
PARTNERS

www.hip3.net
2280 Valley Vista Rd
Knoxville, TN 37932